63D CONGRESS
1st Session

SENATE

DOCUMENT
No. 171

THE INCOME TAX

OPINIONS

OF

HON. JOHN K. SHIELDS
OF TENNESSEE

HON. CORDELL HULL
OF TENNESSEE

AND

THURLOW M. GORDON
SPECIAL ASSISTANT TO THE
ATTORNEY GENERAL

ON THE PROPOSED INCOME-TAX PROVISION OF THE PENDING TARIFF BILL

PRESENTED BY MR. WILLIAMS

AUGUST 26, 1913.—Ordered to be printed

WASHINGTON
1913


UNITED STATES OF AMERICA
GOVERNMENT PRINTING OFFICE

336.24
Sh61c

THE INCOME TAX.

MEMORANDUM PREPARED BY REPRESENTATIVE HULL, OF TENNESSEE, AUGUST 5, 1913.

The amendment proposed by Senator Root on July 18, 1913, is based upon the theory that the proposed income-tax law can not reach for taxation any income accruing prior to the date of its taking effect, which was required to be taxed under the rule of apportionment under the decision in the Pollock case, even though such income accrued subsequent to the ratification and promulgation of the income-tax amendment to the Constitution. The essence of this contention is that within the meaning of the proposed tax law the tax is limited to the particular income as a specific fund out of which the tax is to be taken, and also that such income becomes principal whenever received, and that principal, therefore, can only be reached for taxation by apportionment, notwithstanding the effect of the recent amendment and the usual method of levying and measuring income taxes by the rule of uniformity as embraced in the proposed law and in former laws and practices of the United States Government.

Prior to the Pollock decision Congress had exercised the broadest power to impose the tax on incomes by the rule of uniformity, from whatsoever source derived. The great question raised in the Pollock case did not go to the power of Congress to impose the tax, but to the question of whether the power had been exercised according to the method prescribed by the Constitution—that is to say, whether a power to tax, limited only by one exception and two qualifications, was being used according to the restrictions as to the method prescribed for its exercise. The Pollock decision held that only certain classes of incomes were excise taxes and as such leviable by the rule of uniformity, while certain other classes, viz, rent of real estate, and incomes derived from invested personality, were of such a nature that a tax laid upon the same constituted a direct tax, and which must fall under the rule of apportionment. Prior to this decision the policy of the Government and the decisions of the courts were to the effect that all taxes upon incomes being considered excise taxes might be levied under the rule of uniformity and might be measured by the income accruing during the preceding year or preceding years.

The income-tax act of August 5, 1861, provided that the tax should be assessed "upon the annual income for the year preceding the 1st of January, 1862," thus including the income that had accrued during the seven months next preceding the passage of the law. The act of July 14, 1862, required the tax to be imposed upon the income that had accrued during the previous six and one-half months of that year prior to the date of the passage of the act.

The English act of June 28, 1853, likewise applied to all income accruing from the 5th day of the preceding April.

In the case of Stockdale *v.* Insurance Co. (20 Wal., 331) the Supreme Court said:

> The right of Congress to have imposed this tax by a new statute, although the measure of it was governed by the income of the past years, can not be doubted; much less can it be doubted that it could impose such a tax on the income of the current year, though part of that year had elapsed when the statute was passed. The joint resolution of July 4, 1864, imposed a tax of 5 per cent on all income of the preceding year, although one tax on it had already been paid; and no one doubted the validity of the act or attempted to resist it.

The soundness of this language was later sustained in the case of Patton *v.* Brady (104 U. S., 608).

In the case of Maine *v.* Grand Trunk Ry. (142 U. S., 217–229) the Supreme Court suggested that income for one year might properly be taken for the measure of all future years.

Again—

> unless the Constitution prohibits retrospective legislation, the basis of the assessment of taxes may as lawfully be retrospective as the reverse; that is to say, it may as well have regard to benefits theretofore received as to those that may be assessed thereafter. (Cooley on Taxation, 3d Ed., 492.)

Retrospective legislation is not prohibited.

In Drexel & Co. *v.* Commonwealth (46 Pa. St., 31, at p. 40) the Supreme Court said:

> It is clearly constitutional as well as expedient in levying a tax upon profits or income to take as a measure of taxation the profits or income of the preceding year. To tax is legal, and to assume as a standard the transactions immediately prior is certainly not unreasonable.

Additional authorities might be cited to the same effect. As stated, these authorities only had in mind the imposition of an income tax as an excise or indirect tax by the rule of uniformity, whereas it should be borne in mind that under the Pollock decision incomes from rent of real estate and invested personalty are direct taxes, and until the ratification of the recent amendment could only be levied by apportionment. The recent amendment, however, provided that Congress might impose a tax on incomes without apportionment, whether considered as direct or indirect taxes. It is evident, therefore, that in so doing the rule of uniformity must govern. The question then arises as to whether Congress may thus impose a tax upon all incomes from whatever source derived, whether considered direct or indirect taxes, in the same manner in all essential respects that it had, previous to the Pollock decision, imposed the tax upon incomes as an excise and under the rule of uniformity. If so, it necessarily follows that the tax may be measured by all income accruing from and after the ratification of the constitutional amendment.

Does not the very nature and purpose of a tax on incomes accord with the foregoing view? In the broad and usual sense of tax laws the Government, for example, might impose a tax upon property according to its value by a direct and specific levy upon the property itself, and in concrete form, either real or personal; this would be done by apportionment; or if it was sought to impose a capitation tax, which is one upon the person solely, without any reference to his property, real or personal, this would be effected by apportionment, while,

upon the other hand, a tax laid upon any business, or franchise, or employment, or income would fall under the rule of uniformity.

The Pollock decision held the income tax invalid not on the ground that income could become capital and escape the tax, but on account of its origin; that it was, in effect, a tax on realty and personalty. The only proper inquiry in the light of the recent amendment, therefore, is not as to the *origin* or *disposition* of the income in question, but what amount of income accrued to a taxable individual during a given period. It must follow that the account of annual income required of a citizen is for the purpose solely of ascertaining what amount of tax ought to be imposed upon him in consequence of his having made profits and collected by the Government not necessarily out of the specific income in question but from the general property of the taxpayer as well. (61 North Carolina, 87.)

This view refutes the theory both that income may become principal, and thereby escape taxation, and also the *objection as to retrospective legislation.*

In the language of the Supreme Court (8 Wal., 234):

> The tax is payable by the person because of his income, according to its amount and without reference to the way in which it was obtained.

The proposed measure would require no act of the citizen until the 1st of January next. It would assess and collect a tax off the individual during next year. Until the 1st day of January the citizen could not balance off against his gross profits his losses, expenses, etc., and ascertain his net income for the preceding year. Until the close of the year the citizen could not know whether his income would be absorbed by losses, expenses, etc., or otherwise disposed of without even being received, nor in fact could he know whether he would have *any net income* until he had balanced his receipts and expenditures *after* the end of the year. Within the meaning of the proposed tax the cumulating items of profit must necessarily *remain in abeyance* until the expenditures for the year are deducted therefrom at the end of the year before it could be known whether there was any sum remaining that would or *could become capital.*

The framers of the Constitution prescribed two great classes of taxes. The sole practical basis for this division related to the method of their imposition, viz, those that were to be apportioned were called direct taxes, while those to be levied by the rule of uniformity were called indirect taxes. No court has ever inquired whether a tax is direct or indirect except for the purpose of determining whether it shall be levied under the one or the other rule just stated. *Income* from real estate and invested personalty is now as fully exposed to the taxing power of the Government under the rule of uniformity as is *income* from trades, professions, etc. The inquiry is not whether profits from any source are *property,* but are they *income.* If so, they are taxable.

The Pollock decision held that as to certain classes such profits were property and not income; but the recent amendment, in its necessary effect, revoked this doctrine and said they shall be treated as any other kind of income for the purpose of an income tax.

Under the proposed measure income is both the subject and the measurement of the tax. The recent amendment gives Congress the

power to tax all classes of income without apportionment. Certainly, then, Congress may measure the tax by the same income. The Supreme Court has held that where the power to lay a tax exists it may be measured by the income from property *not in itself taxable.* (Flint *v.* Stone Tracy Co., 220 U. S., 107; U. S. Express Co. *v.* Minn., 223 U. S., 335.)

The constitutional amendment simply exempts the entire tax to which it relates from the rule of apportionment. It then becomes utterly immaterial to inquire whether the tax is direct or indirect or as to the origin or source of the income or its disposition—the only inquiry pertinent and necessary is, What amount of net income accrued to an individual during a given taxing period? The tax is thereupon measured by the same and collected out of *his general property.*

From any viewpoint it must be agreed that Congress would impose a tax with respect to the annual net income of the citizen, and the tax to be measured by such income, whether the same or parts thereof be considered *property* or *otherwise.* Had the recent amendment been a part of the Constitution when the Pollock case was decided there is no reason to suppose that even for the purpose of income taxation any class of income would have been held to be *property* in the *taxing* sense whatever its character or nature may have been considered in *other senses.* Before the recent amendment the direct tax was considered a tax in terms on property, real or personal, whereas all other taxes related to businesses, privileges, franchises, etc., though measured by different methods.

These latter taxes are taken from the general property of the citizen, just as the former, though not imposed in terms thereon. The recent amendment simply transferred certain categories of income from one of the great clases of taxes to the other, to all intents and purposes if not in name. This transfer makes all incomes conform to the tax-meaning definition of the same as prescribed by all the courts, text writers, commentators on the Constitution, and acts of Congress prior to the Pollock decision.

Income has been defined as "the gain which proceeds from labor, business, *or property* of any kind; the profits of commerce or business." (44 Pa. St., 347; 42 L. A., 428; 28 L. R. A., 48.)

Also an income tax is defined as "a tax which relates to the product or income from property or from business pursuits." (60 Ga., 93; 30 S. W., 973.)

It is a tax upon a person in respect of his income imposed in consideration of the amount of his net profits.

A tax on the yearly profits arising from *property*, professions, trades, and offices. (Black's Law Dictionary.)

One which relates to the product or income from property or business pursuits. (97 Ky., 394; 30 S. W., 973.)

Under the general property laws of the States the taxable status of property, real and personal, relates to the date fixed by law for its assessment. The assessment, when later made, must fix its value as of this date. This may be any day during a taxable year. (141 Ind., 159; 109 Fed., 726.)

An income tax is assessed and collected during the year subsequent to the accrual of the income returned and by which the tax is meas-

ured. Under a tax imposed with respect to net incomes the citizen may be required to return for the purpose of the measurement of the tax either his income for the preceding year, or his average income for a designated number of preceding years, or his estimated income for the current year. This view is sustained by previous citations herein.

It therefore follows that Congress at least during any period of the present year may impose and collect a tax on all incomes accruing subsequent to the promulgation of the recent constitutional amendment, and it is strongly probable that the constitutional amendment had the effect to empower Congress to measure the tax by all income accruing from the 1st day of January last. The power to impose the tax has existed during the entire year, and there has been no impediment to its imposition under the rule of uniformity during most of the year, and under the weight of authority in the States, together with the construction placed upon the National Constitution by the Supreme Court in the Legal Tender and other cases, no reason appears why the tax now proposed could and should not be measured by the income accruing from the first of the year.

Such latter provision would provide for the doing of no act prior to December 31 next which would otherwise have been done by the citizen; it would undo nothing, it would neither *take away* nor *impair* any vested right. (4 Nevada, 313.)

The language of a constitutional amendment should be read in connection with the known condition of affairs out of which the occasion for its adoption may have arisen, and then construed if there be therein any doubtful expressions, in a way, so far as is reasonably possible, to forward the known purpose or object for which the amendment was adopted. (Maxwell *v.* Dow, 176 U. S., 581.)

DEPARTMENT OF JUSTICE,
OFFICE OF THE ATTORNEY GENERAL,
Washington, D. C., August 6, 1913.

Hon. F. M. SIMMONS,
United States Senate.

MY DEAR SENATOR: Replying to your letter of July 30, in which you inclose an amendment offered by Senator Root to the income section of House bill 3321, together with his remarks at the time of its introduction, and asking for my views with reference to the Senator's contention, permit me to say:

I am sending you two separate memorandums, one which Congressman Hull very kindly prepared upon my request, and the other prepared by one of the assistants in the department. I hope they will answer your demands.

It seems to me that the Senator's proposition is not well founded. The practice in the past, the necessity for moving along practical lines with respect to tax matters, together with the other suggestions contained in the inclosed memorandums, are adequate to overthrow his contention.

With best wishes, faithfully, yours,

J. C. MCREYNOLDS,
Attorney General.

Re Mr. Root's Proposal to Amend Income-Tax Law.

[Memorandum for the Attorney General by T. M. Gordon, July 31, 1913.]

Mr. Root suggests that the income-tax law must be amended to operate only from the date of passage. His theory is that income, once accrued, becomes principal. Hence there can be no such thing as an "income tax" on past income. Such a tax is a tax on principal, a direct tax, still requiring apportionment, despite the fifteenth amendment. I do not agree with Mr. Root.

The whole question turns upon what the words "taxes upon incomes from whatever source derived" mean as used in the sixteenth amendment.

An income tax is sui generis. It is a legal fiction, a purely metaphysical conception, very difficult to define or classify. It seems to me, however, that it must be treated in a practical sort of way, and that the definition which Mr. Root's argument assumes builds up an unduly elaborate legal fiction, unwarranted by authority and very unfortunate in its results.

Of course Mr. Root can not have in mind that a tax to be an *income* tax must actually be collected, or even assessed, before income ceases to be income. Such a requirement would be wholly impossible to comply with. For example, such a requirement would render it improper to assess the tax upon income for the preceding year, as is done by this law, and as is the universal custom of income-tax laws both in this country and in England.

Apparently Mr. Root does assume, however, that a tax can not be a "*tax upon income*" unless the law levying the tax is in active operation at the precise instant that the income accrues, so that it may then seize upon the income *constructively;* i. e., in legal fiction. The law is conceived as a sort of invisible net interposed between the individual and his source of income. The Federal 1 per cent is caught, branded, and turned loose again, as it were, to be counted and collected at a later day by the assessor. Of course physical analogies can not express precisely how the legal fiction solves such difficulties as the fact that any individual's yearly income can not be known till the end of the year, or the situation of the merchant who may gain in one transaction and lose in the next; nevertheless it must be admitted that such a conception of a tax on income, though very refined and metaphysical, is intellectually possible.

I do not think, however, that usage, as evidenced by prior laws upon the subject and by judicial decisions, has ever restricted the meaning of the words to tax laws which might be conceived to operate in such a fashion.

I. *First, as to the word "income,"* I do not think that word necessarily implies a *specific fund* from which the tax must be taken. A man who possessed no vested right to anything might properly say, "My present income is $5,000 a year." If that *is* his "*present income,*" why may he not be taxed upon it?

II. *That leads to the significance of the word "upon."* This word is used in such a wide variety of ways that it is very difficult to define exactly what we do mean when we say a tax "*upon*" anything Taxes, generally speaking, are really contributions from *persons,* who are classified for tax purposes with reference to various character-

istics, as ownership of land, carrying on a certain kind of business, etc. The factor or factors with reference to which individuals are classified is usually said to be the thing "*upon*" which the tax is levied. (*24 Harvard Law Review*, pp. 41–42.) Thus Mr. Kennan, in his recent book on *Income Taxation*, defines an income tax as "*a tax the amount of which is determined with reference to the income of the taxpayer*" (p. 9). In other words, "upon" usually means "*with reference to*," or "*based upon*," or "*measured by*." And an income tax is a tax based upon income or measured by income, not carved out of a specific fund of income.

In this sense a tax can be "upon" a thing which a person no longer owns or a state of things which has now ceased to exist. As Mr. Cooley says (Cooley, Taxation (3d Ed.), pp. 492, 493, 494):

> Unless the Constitution prohibits retrospective legislation the basis of an assessment of taxes may as lawfully be retrospective as the reverse; that is to say, it may as well have regard to benefits theretofore received as to those which may be assessed thereafter. (Locke *v.* New Orleans, 4 Wall., 172, p. 492.)
> * * * Nor in apportioning the tax between individuals is there any valid objection to making it on consideration of a state of things that may now have come to an end; *as where a tax is imposed on the extent of one's business for the preceding year instead of upon an estimate of the business for the year to come.* Drexell *v.* Commonwealth, 46 Pa. St., 31. (People *v.* Gold Co., 92 N. Y., 383.) * * * One may be taxed upon property which he has long ceased to own when the tax is levied (pp. 493–494).

Locke *v.* New Orleans (4 Wall., 172), cited supra, held a State statute imposing an additional tax on property according to the assessment for the previous year, and also according to the assessment for the year before that, but not exceeding the tax already imposed according to those assessments, was constitutional.

Drexell *v.* Commonwealth (46 Pa. St., 31), also relied on by Mr. Cooley, related to an income tax. The court said (p. 40):

> This act clearly intended to levy a tax of 3 per cent on the profits or income of the business, and was not meant to tax capital. Profits must necessarily be the net profits of the business, and the Commonwealth was to receive of them 3 per cent. It was in fact a tax upon the income of the business in which the defendants were engaged. The English income tax and the United States income tax are based upon the incomes received in preceding years. The present United States income tax is laid upon the income of 1862, and the act of Congress of the 5th of August, 1861 (12 Stat. L., 309), expressly declares that "the tax herein provided shall be assessed upon the annual income of the persons hereinafter named, for the year next preceding the 1st of January, 1862, and the said taxes, when so assessed and made public, shall become a lien upon the property or other sources of said income for the amount of the same, with the interest and other expenses of collection until paid.
> It is clearly therefore perfectly constitutional as well as expedient, in levying a tax upon profits or income, to take as the measure of taxation the profits or income of a preceding year. To tax is legal, and to assume as a standard the transactions immediately prior is certainly not unreasonable, particularly when we find it always adopted in exactly similar cases. The tax is graduated upon each individual upon his individual receipts.

In People *v.* Gold Co. (92 N. Y., 383) a tax upon the franchises of corporations, based upon dividends for the year preceding the passage of the law, was upheld.

> The fact that the amount of the tax may in some cases be fixed by reference to the business of the company during the year does not make the act retrospective. The burden it imposes is future and for future expenditures. It is competent for the legislature to adopt such method of valuing the franchises or property of corporations for the purpose of taxation as it deems proper (pp. 390–391).

In Glasgow *v.* Rouse (43 Mo., 479) an additional tax on incomes, levied according to the assessment of the preceding year, was upheld. The court declared this to be—

in entire harmony with the then existing revenue law, which provided that the taxes collected for any year should be based on an assessment made for the previous year (p. 488).

III. As appears from the cases supra, the courts do not go through an elaborate fiction to prove that the income is still income at the time the tax attaches. An income tax is still an income tax, whether it is levied on this year's income or last year's income or (as has actually been done in the case of professional incomes by the English income-tax statutes since earliest times) on the *average* income for a period of years.

Furthermore, *every one* of the earlier Federal income-tax statutes and every one of the English statutes that I have examined not only based each year's tax upon the income for the preceding year, but also based the tax for the first year upon income *which had already accrued before the passage of the act.* It is only fair to assume that the kind of income tax to which the 16th amendment refers is the kind of income tax which had been called an income tax in Federal statutes, and levied and collected many times theretofore.

The Federal income tax laws are as follows:

Act of August 5, 1861 (12 Stat., 292):

The tax herein provided shall be assessed upon the annual income of the persons hereinafter named for the year next preceding the time for assessing said tax, to wit, *the year next preceding the first of January, eighteen hundred and sixty-two.* (12 Stat., 309, § 49.)

Act of July 1, 1862 (12 Stat., 473, 474):

* * * The duty herein provided for shall be assessed and collected upon the *income for the year ending the 31st day of December next preceding the time for* levying and collecting such duty; that is to say, on *the first day of May, 1863,* and in each year thereafter.

Act of June 30, 1864 (13 Stat., 223, 281, 283):

And the duty herein provided for shall be assessed, collected, and paid upon the gains, profits, or income for the year ending the 31st day of December next preceding the time for levying, collecting, and paying such duty (p. 281, § 116). * * * shall be levied on the first day of May (p. 283, § 116).

Act of July 4, 1864 (13 Stat., 417):

* * * There shall be levied, assessed, and collected on the *first day of October, 1864,* a special income duty upon the gains, profits, or income *for the year ending the 31st day of December next preceding* the time herein named.

Act of March 2, 1867 (14 Stat., 471, 478, 480):

And the tax herein provided for shall be assessed, collected, and paid upon the gains, profits, and income for the year ending the 31st day of December next preceding the time for levying, collecting, and paying the tax (p. 478).

Provided, That the tax on *incomes for the year 1866 shall be levied on the day this takes effect* (p. 480).

Act of July 14, 1870 (16 Stat., 256):

* * * the tax hereinbefore provided shall be assessed upon the gains, profits, and income for the *year* ending on the 31st day of December next *preceding the time for levying* and collecting said tax, *and shall be levied on the 1st day of March, 1871.*

Act of August 27, 1894 (28 Stat., 553, s. 27):

Tax to be levied January 1st, 1895, on income for the year ending December 31st next preceding time of levy (s. 1 and s. 30).

English income-tax laws are as follows:

Act June 22, 1842 (5 and 6 Vict., c. 35): Taxed income from April 5, 1842.

Act June 28, 1853 (16 and 17 Vict., c. 34): Taxed income from April 5, 1853.

Since 1860 the English tax has been reenacted annually (16 Halsbury's Laws of England, 609). The act of April 29, 1910 (10 Edward VII and 1 Geo. V, c. 8, s. 65), is an example, which provides:

(1) Income tax for the year beginning on the *6th day of April, 1909*, shall be charged at the rate of 1s. 2d.

(2) All such enactments as were in force on the 5th day of April, 1909, shall, subject to the provisions of this act, have full force and effect with respect to any duties of income tax hereby granted.

IV. *The economic conception of an income tax is against Mr. Root's interpretation.*

From the economist's point of view the income tax is a contribution by each individual, *based upon his ability to pay, measured by his income*. A man's income for the preceding year is the most natural measure of his ability. And, as we have seen above, all previous income-tax measures have been levied on that basis.

Nor would it make the tax a "capitation" tax to consider it in this way. "Capitation" taxes, in the constitutional sense, are *poll* taxes, levied upon all men *equally*, without regard to wealth or extrinsic circumstances. (Cooley, Taxation (3d Ed.), p. 28; Hylton *v.* U. S., 3 Dall., 171; Springer *v.* U. S., 102 U. S., 586; Head Money cases, 18 Fed., 135, 139; Glasgow *v.* Rouse, 43 Mo., 480.)

It is true that in Pollock *v.* Farmers' Loan & Trust Co. (158 U. S., 601) the court stated the economic theory and expressly refused to follow it to its logical conclusion in the case of income from *property*, insisting upon the necessity of considering also the *source* whence the income was derived. (See p. 629.) But that holding does not help Mr. Root's contention. The holding was that a tax upon the income of property is a tax upon the property itself, not because the *income* is property, but because the tax reaches back *through* the income to the source from which it springs. (Knowlton *v.* Moore, 178 U. S., 41, 82.) Therefore the sixteenth amendment, which was passed with the express purpose of escaping that decision, must be held to give power to levy a direct tax on property, at least *that kind* of a direct tax on property which is measured by its income. As was suggested above, if the sixteenth amendment is really designed to permit a tax on *property measured by income*, there is no reason why income already accrued may not be taken as the standard.

V. *The usefulness of the tax as a war measure.*

This was one of the reasons most persistently urged for the adoption of the sixteenth amendment. Mr. Root's interpretation would seriously impair its effectiveness, however. How could large amounts of money be raised with any degree of quickness if Congress must wait a year for income to accrue? And of course Mr. Root's objection would apply to an increase in the *rate* of taxation as well as to the original imposition of a tax. That this is a consideration of real substance is shown by the fact that the income tax of 1861, for instance, was aimed at income for the entire year of 1861, though passed on August 5 of that year. (12 Stat., 292.) And as the war proceeded it was found necessary to levy (act July 4, 1864) a special

income tax on income for the whole year *1863*. (13 Stat., 417.) It would be very unfortunate if the sixteenth amendment would not permit such a war measure, and for Congress to assent to such a construction by amending the law at this time would be a contemporaneous legislative interpretation of some weight if the question ever arose hereafter.

Faithfully,

THURLOW M. GORDON,
Special Assistant to the Attorney General.

OPINION OF HON. JOHN K. SHIELDS, SENATOR FROM TENNESSEE, FURNISHED FINANCE COMMITTEE AT REQUEST OF THE CHAIRMAN OF THAT COMMITTEE.

AMENDMENT OFFERED BY MR. ROOT TO H. R. 3321, JULY 18, 1913.

The section of the bill imposing an income tax is in these words:

A. Subdivision 1. That there shall be levied, assessed, collected, and paid annually upon the entire net *income* arising or accruing from all sources in the preceding calendar year to every citizen of the United States, whether residing at home or abroad, and to every person residing in the United States, though not a citizen thereof, a tax of 1 per centum per annum upon such *income* except as hereinafter provided; and a like tax shall be assessed, levied, collected, and paid annually upon the entire net income from all property owned and of every business, trade, or profession carried on in the United States by persons residing elsewhere.

Subdivision 2 merely provides for an additional tax upon larger incomes in all things as provided in subdivision 1. (Sec. 2, subdivs. 1 and 2, p. 165.)

Thus it plainly appears that the tax is imposed regardless of whether the income or property represented by it had its source in profits or gains from real and personal property or business, and includes them all.

The method provided for computing or assessing the tax makes no distinction on account of the source of the income, and is the same whether it arises from property or business. That portion of the bill providing for this, after allowing certain deductions, contains a provision in these words:

The said tax shall be computed upon the remainder of said net income of each person subject thereto, accruing during each preceding calendar year ending December thirty-first: *Provided, however*, That for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be computed on the net income accruing from March first to December thirty-first, nineteen hundred and thirteen, both dates inclusive, after deducting five-sixths only of the specific exemptions and deductions herein provided for. (Sec. 2, div. D, pp. 172–173.)

The amendment proposed by Mr. Root, July 18, 1913, is as follows:

On page 172 strike out the word "March," and on page 173 all of line 1, and in line 2 the words "both dates inclusive," and insert in lieu thereof the words "the passage of this act."

The object of this proposed amendment, or, at least, its effect would be to reduce the measure of the tax imposed for the current year to incomes accruing after the passage of the bill.

The reasons advanced by Mr. Root in support of the amendment, as stated by him at the time it was proposed, are as follows:

I have introduced a brief amendment to the tariff bill, which I shall ask to have referred to the Committee on Finance; but I wanted to call the Senators' attention

to the precise point of the amendment. It is an amendment to the provision that the income tax shall be computed on incomes accruing from March 1, to December 31, 1913.

I think the provision will encounter very serious question. The change I propose is to have the income for the first year computed from the passage of the Act, rather than from a fixed date—March 1, 1913.

The reason why I think it would be wise to make the change is that all direct taxes must be apportioned unless they come within the amendment relating to the income tax. We can impose a tax upon incomes without apportioning it because of the amendment, but we can not impose any other direct tax without apportionment. When income is received it immediately becomes principal. The income that was received the 1st day of July of the present year, having been received, became principal, and no law hereafter can tax it without apportionment, any more than we can tax now the income that was received 10 years ago without apportionment.

So if the bill becomes a law with the provision in it that has been reported from the committee you will find yourselves endeavoring in one sentence to tax income that comes under the amendment, and to tax past income, income received, reduced to possession, and turned into principal before the passage of the act, and that you can not do without apportionment.

It is to avoid that difficulty, which I am sure is very serious, that I propose the amendment which I now ask to have referred to the Committee on Finance. (Cong. Record, p. 2788.)

The argument advanced to support the contention of the Senator is predicated solely upon the assumption that profits, dividends, and other moneys, constituting an income, when received, immediately become "principal," or, in other words, is incorporated into the corpus of the estate of the taxpayer, and therefore not subject to direct taxation without apportionment. This involves the further assumption that the tax imposed can only be collected out of the income of the taxpayer, or, in other words, that his general estate can not be subjected to its payment.

The question, whether or not an income accrued immediately and automatically becomes principal, or a part of the general estate of the owner, whether sound or unsound in economics or financial evolution, is not in my opinion material to the question involved.

But it is unsound. An income is defined to be:

> That gain which proceeds from labor, business, property, or capital of any kind, as the produce of a farm, the rent of houses, the proceeds of professional business, or money or stock in funds, etc.; salary, especially the receipts of a private person, or a corporation, from property.

This is the natural and obvious sense of the term, and it is so used in the constitutional amendment and in this bill. The gain, profit, or acquisition constituting the income when it accrues and is ascertained becomes an entity and property as much as a farm, bonds, corporate stocks, or other property from which it may have had its source. That it may automatically immediately become incorporated into the estate of the owner, or invested, thereafter to yield an income, or is spent, given away, or consumed, does not destroy the property entity of the value it had when it accrued. The fact that the property existed and was owned by the taxpayer at one time is indestructible.

I suppose the objection of the Senator goes only to computations on incomes arising from property, real and personal, and not to those on incomes from business.

The question really presented for consideration is, whether the provision of the bill for the tax for the current year is retroactive in its operation, and imposes a liability for taxes before the enactment of the law, and is for this reason unconstitutional.

The constitutional amendment under which this tax, in part, is imposed without apportionment ordains:

> The Congress shall have power to lay and collect taxes *on incomes* from whatever source derived, without apportionment among the several States and without regard to any census or enumeration.

It is well settled that—

> The language of a constitutional amendment should be read in connection with the known condition of affairs out of which the occasion of its adoption may have arisen, and then construed, if there be therein any doubtful expressions, in a way, so far as is reasonably possible, to forward the known purpose or object for which the amendment was adopted. (Maxwell *v.* Dow, 176 U. S., L. Ed., Book 18, p. 597.)

It is a part of the history of this country that much of the personal property owned by every one, and the great accumulations of wealth in the hands of the few, had for years escaped taxation. They could not be taxed direct without apportionment, which was not deemed advisable. The income tax law of 1894 was enacted to remedy this injustice and to make this property bear its just proportion of the expenses of the Government.

The Supreme Court of the United States held that tax, in so far as it was imposed upon incomes received from real estate and personal property, to be a direct property tax and, being levied without apportionment, unconstitutional. The tax upon incomes which arose from other sources, and upon which an excise tax could be imposed, was not held void for that reason, but the contrary conceded. (Pollock *v.* Farmers' Loan & Trust Co., 158 U. S., 618, 630; L. Ed., Book 39, 1119, 1123.)

The sixteenth amendment to the Constitution was proposed and adopted to authorize Congress to impose a tax like that of 1894, after which this is modeled, and which is proposed to be enacted under that power, in so far as it taxes incomes arising from real and personal property. Congress already had the power to impose a tax without apportionment on incomes arising from gains, profits, or other acquisitions in business, ordinarily called an excise tax. (Flint *v.* Stone Tracy Co., 220 U. S., 106; 55 L. Ed., 398.)

There are two grounds upon which, in my opinion, the tax for the current year can be sustained.

First. The Congress has general power to lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defense and general welfare of the United States, unlimited save that duties, imposts, and excises shall be uniform throughout the United States, and no capitation or other direct tax shall be laid unless in proportion to the census or enumeration, directed to be taken decennially, nor on articles exported from other States. (Constitution, Art. I, secs. 8 and 9.)

The Constitution contains no provision prohibiting the Congress from imposing a tax upon property owned or business done by the taxpayer previous to the enactment of the law levying the tax. The general rule is that the Congress, within constitutional limitations, has absolute power to determine the objects of taxation and the method of the assessment of the tax. (Cooley's Con. Lim., 737; Flint *v.* Stone Tracy Co., 220 U. S., 167; Weston *v.* City of Charleston, 2 Pet., 466.)

Therefore if the bill be construed to impose the tax for the current year on account of the ownership of incomes received—property

owned and business done previous to the enactment of the law—it is within the power of Congress, without constitutional objection, and valid.

There is no constitutional prohibition of retroactive legislation which will affect this tax. (Black's Con. Law, 753; Cooley's Con. Lim., 529; Satterlee *v.* Matthewson, 2 Pet., 380; Drehman *v.* Stifle, 8 Wall., 595.)

If the constitutional amendment changes or authorizes Congress to change the classification of a tax on incomes derived from property, from that of a direct tax to that of an excise tax, and the tax here imposed is one of the latter class, then the provision for computing incomes before the enactment of the bill is clearly a mere method of assessment and not only allowable, but usually done in assessing excise taxes. The authorities authorizing this manner of assessment of excise taxes will be hereafter stated.

Second. The provision of the bill requiring incomes received by the taxpayer from all sources, from March 1, 1913, to be computed in ascertaining the tax to be paid for the current year is not the imposition of a retroactive tax, but the method of assessment of the tax imposed for that part of the current year after the enactment of the law, consisting in part of a property tax and in part of an excise tax, and is valid and constitutional.

It is immaterial what the tax is called. The courts will treat it according to its correct classification as ascertained by the legislative intent disclosed in the bill when construed in the light of its legislative and judicial history. I am inclined to think the tax imposed is a property tax in part and an excise tax in part. It is a property tax so far as imposed upon incomes accruing to the taxpayer from real and personal property, and an excise tax so far as laid upon incomes arising from all other sources. I do not think the constitutional amendment was intended to change the classification of the tax, but merely to allow it to be imposed without apportionment.

In so far as it is a property tax, it is imposed upon the taxpayer as the owner of so much property—that certain portion in value of his property which he acquired as an income from real and personal property—during certain periods of the current year, from March 1 to December 31, and thereafter annually. The extent of the property—the portion of the estate of the taxpayer upon which he is taxed—is thus measured by the income received during said periods, to be ascertained and fixed as in the bill prescribed. This, under the Pollock cases, is a direct tax, but it is now authorized, without apportionment, by the constitutional amendment under which it is proposed to be enacted.

It is an excise tax so far as it is imposed on incomes from all other sources, as has been decided by the Supreme Court in many cases.

There seems to be no valid objection to imposing the two classes of taxes in the same law. This was done in the act of 1894 and not considered objectionable. The court referring to it in the Pollock cases, expressly stated that this point did not affect its decision. (158 U. S., 636; L. ed., 1125.)

The Congress, within constitutional limitations, has plenary power to select the objects of taxation and the methods by which the tax imposed shall be levied, assessed, and collected. It may, with proper uniformity, tax all the property of the taxpayer or only a

portion or a certain kind of it. It may impose an excise tax on all business, avocations, or on part of them. It also has almost unlimited power in providing for the selection of the property to be taxed, and all necessary machinery for the assessment of the same for taxation and for the collection of the tax. These principles are elementary. (Cooley's Con. Lim., 737, 739; Cooley's Taxation, vol. 1, 602–604.)

In the case of Flint *v.* Stone Tracy Co. (230 U. S., 167, 55 L. Ed., 420) it is said:

> We must not forget that the right to select the measure and objects of taxation devolves upon the Congress and not upon the courts, and such selections are valid unless constitutional limitations are overstepped.

All the authorities agree that the basis of an assessment for taxation may be retrospective. (Cooley on Taxation, vol. 1, p. 492.)

The same method, it is true, is here provided for assessing the property tax and the excise tax imposed, but I can see no objection to the bill on this account. It is equally applicable to both taxes and makes the machinery less complicated and easier of operation. Direct taxation by reason of the ownership of property and an excise tax upon business are merely different methods by which the same end is reached; that is, by which the taxpayer is made to contribute out of his property to the support of the Government.

As before stated, the provision of the bill requiring the computation of incomes received by taxpayers during the periods mentioned in the bill is merely the basis for the assessment of the tax, and it is well settled that incomes received before the law is passed may be considered in ascertaining the tax to be paid for the first year.

The excise cases decided by the Supreme Court of the United States sustain these conclusions. They are directly in point in so far as the property taxed arises from incomes from business subject to an excise tax and clearly analagous where the income arises from real and personal property, both of which are to be found in this bill.

The court has held in all these cases that the tax to be collected may be measured by the business done, the profits made, the dividends accrued, and the gains made for periods previous to the enactment of the law imposing the tax, in some other cases a part of the year, like the present law, and in others the year previous to that in which the law was enacted.

It is also held that where the basis fixed for the assessment is a percentage on the capital stock or business done by a corporation, and that in this way assets which are exempt from taxation and business not taxable are included in making the assessment, the validity of the tax imposed is not affected.

In Home Ins. Co. *v.* N. Y. (134 U. S., 594; 33 L. Ed., 1025) the tax in question was imposed upon the privilege of the complainant to do business as a corporation within the State and was measured by the extent of the dividends of the corporation of the current year upon the capital stock, some two million dollars of which were invested in bonds of the United States exempt from taxation. The tax was attacked because this mode of assessing the same included the value of exempt property. The court, in sustaining the tax, said:

> It is not a tax in terms upon the capital stock of the company, nor upon any bonds of the United States composing a part of the stock. The statute designates it a tax upon the "corporate franchises or business" of the company, and reference is only

made to its capital stock and dividends for the purpose of determining the amount of the tax to be enacted each year. The validity of the tax can in no way be dependent upon the mode which the State may deem fit to adopt in fixing the amount for any year which it will exact for the franchise. No constitutional objection lies in the way of a legislative body prescribing any mode of measurement to determine the amount it will charge for the privilege it bestows.

The case of the State of Maine *v.* Grand Trunk Ry. Co. involves an excise tax levied by the State upon railroad corporations for the privilege of exercising their franchise within the State, the tax being fixed by a certain percentage of the transportation receipts of the company, including interstate and foreign commerce, for the previous year. The tax was assailed upon the ground that it was a burden upon interstate commerce and the business done in a former year. The court sustained the tax. In the opinion, among other things, it is said:

> The character of the tax or its validity is not to be determined by the mode adopted in fixing its amount for any specific period or the time of its payment. The whole field of inquiry into the extent of revenue from sources at the command of the corporation is open to the consideration of the State in determining what may be justly exacted for the privilege. * * *
>
> And if the inquiry of the State as to the value of the privilege were limited to the receipts of certain past years instead of the year in which the tax is collected, it is conceded that the validity of the tax would not be affected; and if not, we do not see how a reference to the results of any other year could affect its character. There is no levy by the statute on the receipts themselves, either in form or fact; they constitute, as stated above, simply the means of ascertaining the value of the privilege conferred.

In Stockdale *v.* Atlantic Ins. Co. (87 U. S., 341, 22 L. Ed., 350), an excise tax assessed upon dividends declared by the company previously, was held to be valid. Mr. Justice Miller in his opinion said:

> The right of Congress to have imposed this tax by a new statute, although the measure of it was governed by the income of the past year, can not be doubted; much less can it be doubted that it could impose such a tax on the income of the current year, though part of that year had elapsed when the statute was passed. The joint resolution of July 4, 1864, imposed a tax of 5 per cent upon all incomes of the previous year, although one tax on it had already been paid, and no one doubted the validity of the tax or attempted to resist it.

Flint *v.* Stone Tracy Co. (220 U. S., 55 L. Ed., 410)—the Corporation Tax case—is the latest excise tax case. All the cases where excise taxes have been attacked, because in the measurement or assessment of the tax property nontaxable, and profits, incomes, and business accruing previous to the passage of the law, were included and valued, are reviewed, and it is there held that the Government may use these methods in *measuring or assessing* the tax imposed without affecting the validity of the tax.

I think the principle controlling all these cases is the same here involved, and sustains the tax proposed to be imposed.

There is nothing in the amendment requiring the tax to be paid or collected out of the specific moneys constituting the income accruing during said periods, and what the taxpayer does with the moneys constituting his income is immaterial. It can not have the effect to relieve him of the tax imposed upon him as the owner of property of its value. This tax, like all other taxes, is a debt due to the Government, and collectible out of any of the taxpayer's property that may be found. If the law was otherwise, the payment and collection of the tax would be dependent upon the ability of the

taxpayer to dispose of his income before the authorities could seize it for the payment of his just contribution to the expenses of the Government.

The statutes of a majority, if not all, of the States provide that property shall be assessed against the owners upon some certain day of the year and that transfers after that shall not affect the assessment. The owner of the property upon the day of the assessment is liable for the tax thereon according to the assessment made, notwithstanding the general assembly, municipal council, or other taxing power may levy the tax on a subsequent day of the year. The property of the citizens taxed for that year is here measured by that which they own on the day fixed for the assessment, and which is made as of that day. These laws have never been questioned so far as I can find.

The provisions of this bill upon this question are not different from the income tax laws of England and those heretofore enacted in this country.

The English income tax enacted June 28, 1853, provided that the same should be operative and effective from and after April 5, 1852, and of course included incomes accruing previous to its enactment.

The income tax imposed by Congress August 5, 1861, expressly provided that—

> the tax herein provided shall be assessed upon the annual incomes of the persons hereinafter named for the year next preceding the 1st of January, 1862, and the said taxes when so assessed and made public shall become a lien upon the property or other sources of said income for the amount of the same, with the interest and other expenses of collection until paid. (12 Stat. L., 309.)

Here the tax was imposed upon the incomes accruing between January 1, 1861, and August 5 of that year, the day of the enactment of the law.

The act of July 14, 1862, superseding the one above stated, provided for the assessment upon incomes received from and after January 1 of that year, or for a period of six months before the act was passed.

The income tax of 1894, enacted in August of that year, provided for the taxation of incomes from the beginning of the current year and was attacked upon this ground. The question was not decided in the cases which reached the Supreme Court of the United States, but it was held by the Supreme Court of the District of Columbia in the case of Moore *v.* Miller, decided January 23, 1895, that there was nothing in the objection. In that case Hagner, J., said:

> This provision is of the same character as those appearing in the former income acts of the United States.
>
> The first act, passed on the 5th of August, 1861, declared that from and after the 1st of January, 1862, there should be levied an income tax, which should be assessed in the first instance "upon the annual income for the year preceding the 1st of January, 1862," thus including in return the income that had accrued during the seven months next preceding the passage of the law.
>
> The act of the 14th of July, 1862, which superseded the first law, declared that the tax should be levied on the 1st of May, 1863, upon the income of the preceding year ending the 31st of December, 1862, including thereby the six months and a half of the year that had expired at the time the act was passed.
>
> The English act of 1853, passed on the 28th of June, 1853, declared that the income tax thereby established should be operative from and after the 5th day of the preceding April.

No authority was quoted in support of this contention, and I have been unable to discover any if it exists.

But the very point appears to have been decided the other way in 20 Wallace, 331 (Stockdale *v.* Ins. Co.), where Mr. Justice Miller said: "The right of Congress to have imposed this tax by a new statute, although the measure of it was governed by the income of the past years, can not be doubted; much less can it be doubted that it could impose such a tax on the income of the current year, though part of that year had elapsed when the statute was passed. The joint resolution of July 4, 1864, imposed a tax of 5 per cent on all incomes of the previous year, although one tax on it had already been paid; and no one doubted the validity of the act or attempted to resist it."

In a Pennsylvania case, in which a tax in substance was imposed upon incomes, a similar question was presented and held not to affect the validity of the law:

This act clearly intended to levy a tax of 3 per cent on the profits or income of the business, and was not meant to tax capital. Profits must necessarily be the net profits of the business, and the Commonwealth was to receive of them 3 per cent. It was in fact a tax upon the income of the business in which the defendants were engaged. The English income tax and the United States income tax are based upon the incomes received in preceding years. The present United States income tax is laid upon the income of 1862, and the act of Congress of the 5th of August, 1861 (12 Stat. at Large, 309), expressly declares that "the tax herein provided shall be assessed upon the annual income of the persons hereinafter named, for the year next preceding the 1st of January, 1862, and the said taxes, when so assessed and made public, shall become a lien upon the property or other resources of said income for the amount of the same, with the interest and other expenses of collection until paid."

It is clearly, therefore, perfectly constitutional, as well as expedient, in levying a tax upon profits or income, *to take as the measure of taxation* the profits or income of a preceding year. To tax is legal, and to *assume as a standard* the transactions immediately prior is certainly not unreasonable, particularly when we find it always adopted in exactly similar cases. The tax is graduated upon each individual upon his individual receipts.

The Wisconsin income tax law went into effect July 5, 1911, but provided for taxing all incomes received during that year. The act was attacked, among other grounds, upon the contention that it was retroactive and void under the constitution of that State. The court in disposing of this question said:

One further objection we overrule here without comment, for the reason that it seems very unsubstantial, namely, the objection that the law is retroactive and void, because assessed on incomes received during the entire year 1911, while it did not go into effect until July 15 of that year, and also because it includes profits derived from the sale of property purchased at any time within three years previously. (Income Tax cases, 148 Wis., 456, 514.)

In Wisconsin & M. R. Co. *v.* Powers (191 U. S., 379, 48 L. Ed., 229) a statute was sustained which made the income of the railway company within the State including interstate earnings the prima facie measure of the value of the property within the State for the purpose of taxation. In the course of the opinion the court said:

In form the tax is a tax on "the property and business of such railroad corporation operated within the State" computed upon certain percentages of gross income. The prima facie measure of the plaintiff's gross income is substantially that which was approved in Maine *v.* Grand Trunk R. Co. (142 U. S., 217, 228).

The statute of Minnesota, passed for revenue purposes in 1905, levied a property tax to be computed upon the gross receipts of corporations doing both domestic and interstate business, the last of which, of course, could not be taxed by the State, as such a tax would

3 0112 061603863

be a burden upon interstate commerce, and in violation of the commerce clause of the Federal Constitution. The Supreme Court of the United States sustained this statute and upheld the tax. In the opinion delivered for the court by Mr. Justice Day, it is said:

> Upon the whole, we think the statute falls within that class where there has been an exercise in good faith of a legitimate taxing power, the measure of which taxation is in part the proceeds of interstate commerce, which could not, in itself, be taxed, and does not fall within that class of statutes uniformly condemned in this court, which show a manifest attempt to burden the conduct of interstate commerce, such power, of course, being beyond the authority of the State. (Express Co. *v.* Minn., 223 U. S., 335.)

These two last cases seem to be directly in point. They involved statutes imposing property taxes, measured or assessed by methods which involved, in part, the computation of property and incomes not within the taxing power of the State. This was but an application of the general principle that the legislature has *the power to prescribe any method of assessment of property for taxation* that may be deemed wise and efficient, and illustrates the important *distinction between the subject* of taxation and *the method of assessment* of taxation.

I think the amendment without merit, and the provision of the bill called in question constitutional.

○